

***United States Court of Appeals
for the Second Circuit***



**PETITIONER'S
BRIEF**

345-4078

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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IRVING MALAWER and RUTH MALAWER,

Petitioners-Appellants

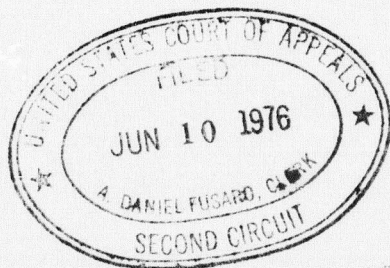
v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee
----- x

BRIEF FOR PETITIONERS-APPELLANTS

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TABLE OF CONTENTS

	<u>Page</u>
Introduction	1
The Facts	2 to 4
Argument- <u>Point I.</u> The Tax Court erred in its findings that the petitioner did not meet the burden of proof with respect to the adoption of a plan to issue Sec. 1244 stock, or with respect to the issuance of said stock.	5 to 10
<u>Point II.</u> The Tax Court erred in its findings that a presumption arises, that information that the petitioner did not introduce at the trial would not support petitioner's claims with reference to the issuance of Sec. 1244 stock.	10 to 12
Conclusion	13

TABLE OF CITATIONS

Cases:	<u>Page</u>
Childs v. Commissioner, 408 F.2d 531 (3rd Cir.1969)	7
Eger, Sofie, 25 CCH Tax Ct. Mem. 986 (1966), <u>rev'd and rem'd</u> , 393 F.2d 243 (2d Cir.1968), 28 CCH Tax Ct. Mem. 850 (1969)	6
Godart v. Commissioner, 425 F.2d 633 (2d Cir.1970)	7
Lichtenberg, Herbert S., 26 CCH Tax Ct. Mem. 583 (1967)	7,12
Morgan, Wesley H., 46 T.C. 878 (1966)	11
Scott, Roland E., 27 CCH Tax Ct. Mem. 735 (1968)	12
Shapiro. Simon, 25 CCH Tax Ct. Mem. 654 (1966)	6
Spillers v. Commissioner, 407 F.2d 530 (5th Cir. 1969)	7
Warner v. Commissioner, 401 F.2d 162 (9th Cir. 1968)	6

STATUTES AND REGULATIONS INVOLVED

Page

Int. Rev. Code of 1954:

Sec. 1244

1,5,6 to 13

Treasury Regulations under the 1954 Code:

Sec. 1.1244(e)-1

8 to 13

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Docket No. 76-4078

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INTRODUCTION

This case is an appeal from the decision of the Tax Court and seeks to reverse the decision of Judge Quealy in determining that the Petitioner did not sustain an ordinary loss in the sum of \$27,782.96 under Sec. 1244 of the Internal Revenue Code on their investment of \$84,587.07 in Realty Transfer Corporation.

The Tax Court erred in its finding that the petitioner did not meet his burden of proof with respect to the adoption of a plan to issue Sec. 1244 stock, or with respect to the issuance of said stock.

The Court erred in its findings that a presumption arises, that information, that the petitioner did not introduce at the trial, would not support petitioner's claims with reference to the issuance of Sec. 1244 stock.

THE FACTS

Realty Transfer Corporation (hereinafter referred to as "Realty Transfer") was incorporated in Florida on August 7, 1957.

On or about November 19, 1959, real property in Winter Park, Florida was purchased by the petitioner and co-investors in the name of Realty Transfer. (A.1)

A bank account was opened for the first time in 1962. No corporation income tax returns were filed for the years 1957 through 1961 inclusive.

The petitioner made investments in Realty Transfer in the total sum of \$84,587.07. The petitioner originally claimed the sum of \$50,000.00 as an ordinary loss under Sec. 1244 and the remaining \$34,587.07 as a capital loss.

The tax returns for the corporation Realty Transfer reflected total common stock of \$169,167.36 (\$27,782.96 as the petitioner's share) and the balance of the petitioner's investment as loans payable to stockholders (petitioner). (A.5 to 17)

At the trial the petitioner conceded that since his share of the stock was only \$27,782.96, that amount was claimed as an ordinary loss and the balance as a capital loss.

Petitioner put into evidence at the trial a document entitled "Minutes of Board of Directors Meeting of Realty Transfer Corporation" held on June 4, 1962 bearing the signature of George Melter an attorney, and an investor, now deceased. The minutes indicated that the directors were also all the stockholders of the corporation and all were stated to be present. (A.18)

The minutes set forth that a plan was adopted whereby fifty (50) shares of stock, each having a par value of Five (\$5.00) Dollars would be issued over a period of not more than two (2) years pursuant to Sec. 1244 for an aggregate amount not to exceed \$500,000.00. Certificates were to be issued for the consideration shown as follows:

<u>Stockholders</u>	<u>Number of Shares</u>	<u>Amount</u>
Jack Malawer	9 5/8	\$ 27,782.97
Irving Malawer	9 5/8	27,782.96
George Melter	11 1/2	24,056.57
Irving Weider	19 1/4	89,544.86
	50	\$169,167.36

The petitioner, Irving Malawer testified that he attended the meeting and that he believed that the signature was that of George Melter. (A.19) The document submitted was a signed duplicate of the minutes of the said meeting. The respondent also submitted at the trial a copy of the original signed minutes. The documents were admitted by the Court pursuant

to the best evidence rule. (A.18)

Petitioner put into evidence original records maintained by Frank Knopf, the accountant for the petitioner, showing his investment in Realty Transfer. The accountant testified that the records showed that the amounts on his records as of June 4, 1962 were the amounts shown on the corporate minutes of said date as consideration for the stock. (A.20 to 23)

No physical evidence of the issuance of the stock certificates to the petitioner was produced at the trial. The corporate tax return for 1962 showed no capital stock as of January 1, 1962, but showed capital stock of \$169,167.36 (petitioner's share \$27,782.96) as of December 31, 1962. The same amount is reflected on the returns for 1963 and 1964.

The corporate returns showed losses as follows:

<u>Year</u>	<u>Loss</u>
1962	\$ -0-
1963	7,879.05
1964	425,118.92

The corporation abandoned the Florida property in 1964 and the corporate return for that year showed no assets as of December 31, 1964, and was dissolved on June 30, 1967 for failure to pay its corporation stock tax to the State of Florida.

ARGUMENT

POINT I

THE TAX COURT ERRED IN ITS FINDINGS THAT THE PETITIONER DID NOT MEET THE BURDEN OF PROOF WITH RESPECT TO THE ADOPTION OF A PLAN TO ISSUE SEC. 1244 STOCK OR WITH RESPECT TO THE ISSUANCE OF SAID STOCK.

On page 16 of its decision the Tax Court stated: (A.24)

"The petitioner has not presented evidence to meet his burden of proof that Realty Transfer adopted a plan to issue Sec. 1244 stock in accordance with Sec. 1244 (c) (1) (A) or that Realty Transfer issued stock pursuant to said plan as required by Sec. 1244 (c) (1) (D)."

Sec. 1244 sets forth the requirements to qualify a loss from an investment in a corporation as an ordinary loss. ¹

1

SEC. 1244. LOSSES ON SMALL BUSINESS STOCK.

(c) Section 1244 Stock Defined.--

(1) In General.-- For purposes of this section, the term "section 1244 stock" means a common stock in a domestic corporation if--

(A) such corporation adopted a plan after June 30, 1958, to offer such stock for a period (ending not later than two years after the date such plan was adopted) specified in the plan,

(B) at the time such plan was adopted, such corporation was a small business corporation,

(C) at the time such plan was adopted, no portion of a prior offering was outstanding,

It has been established that corporate minutes can qualify as a "plan" within the meaning of Code Sec. 1244 (c) (1) (A) if they contain all the required elements of a "plan" as specified in that section of the Code and the regulations thereunder. Sofie Eger 25 CCH Tax Ct. Mem. 986 (1966) rev'd and rem'd 393 F2d (243) 2d Cir. 1968, 28 CCH Tax Ct. Mem. 850 (1969).

Code Sec. 1244(c) (1) (A) requires the corporation to offer the common stock for a period ending not later than two (2) years after the plan was adopted. Thus an otherwise valid written plan may be disqualified if it does not limit the period of the stock offering to two (2) years. Warner v. Commissioner 401 F2d 162 (9th Cir. 1968) Simon Shapiro 25 CCH Tax Ct. Mem. 654 (1966).

1

(D) such stock was issued by such corporation, pursuant to such plan, for money or other property (other than stock and securities), and

(E) such corporation, during the period of its 5 most recent taxable years ending before the date the loss on such stock is sustained * * *, derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities * * *; except that this subparagraph shall not apply with respect to any corporation if, for the period referred to, the amount of the deductions allowed by this chapter (other than by sections 172, 242, 243, 244, and 245) exceed the amount of gross income.

There must be some substantial contemporary objective evidence that a plan was adopted with Code Sec. 1244 in mind, otherwise the corporate minutes will not qualify as a written plan. Godart v. Commissioner 425 F2d 633 (2d Cir. 1970).

The plan must limit the maximum amount of stock to be issued to \$500,000.00 Spillers v. Commissioner 407 F2d 530 (5th Cir. 1969) Childs v. Commissioner 408 F2d 531 (3rd Cir. 1969).

The stock is deemed issued in fact irrespective of the manual issuance of the certificates when the stock is paid for and not when the certificates are actually issued. Wesley H. Morgan 46 TC 878 (1966) Herbert S. Lichtenberg 26 CCH Tax Ct. Mem. 583 (1967).

In the case at bar the corporate minutes dated June 4, 1962 comply with all the requirements set forth supra. Thus the minutes contain all requirements of a "plan" as spelled out therein. In addition the minutes set forth specific references to Sec. 1244 of the Internal Revenue Code which is additional substantial contemporary objective evidence that the plan was adopted with Code Sec. 1244 in mind.

The plan limits the stock issuance for a period of not more than two (2) years from the date of the adoption of the plan (June 4, 1962) and for an aggregate amount not to exceed \$500,000.00.

The minutes further states the stock certificates to be issued, to whom and the consideration, pursuant to the plan.

The stock is deemed issued pursuant to the plan on June 4, 1962 for the consideration set forth therein. It is so deemed, irrespective of the manual issuance of the certificates, since the physical certificates are not required to determine the issuance of the stock.

The Tax Court in its decision on page 13 stated: (A.25)

"Petitioner has failed to provide the records required by Sec. 1.1244(e)-1, Income Tax Regs. respecting the issuance of the alleged 1244 stock": 2

2

REGULATIONS

Sec. 1.1244(e)-1 Records to be kept and information to be filed with the return. - (a) By the corporation. The plan to issue stock which qualifies under section 1244 must appear upon the records of the corporation. In addition, in order to substantiate an ordinary loss deduction claimed by its shareholders, the corporation should maintain records showing the following:

(1) The persons to whom stock was issued pursuant to the plan, the date of issuance to each, and a description of the amount and type of consideration received for each;

(2) If the consideration received is property, the basis in the hands of the shareholder and the fair market value of such property when received by the corporation;

The regulations do not spell out the specific type or the physical records, that are to be maintained, but only state

2

(3) Which certificates represent stock issued pursuant to the plan;

(4) The amount of money and the basis in the hands of the corporation of other property received after June 30, 1958, and before the adoption of the plan for its stock, as a contribution to capital, and as paid-in surplus;

(5) The equity capital of the corporation on the date of adoption of the plan; and

(6) Information relating to any tax-free stock dividend made with respect to stock issued pursuant to the plan and any reorganization in which stock is transferred by the corporation in exchange for stock issued pursuant to the plan.

(b) By the taxpayer. Any person who claims a deduction for an ordinary loss on stock under section 1244 shall file with his income tax return for the year in which a deduction for the loss is claimed a statement setting forth:

(1) The address of the corporation that issued the stock;

(2) The manner in which the stock was acquired by such person and the nature and amount of the consideration paid; and

(3) If the stock was acquired in a nontaxable transaction in exchange for property other than money—the type of property, its fair market value on the date of transfer to the corporation, and its adjusted basis on such date.

that records are to be maintained to show the required information set forth in the regulations. Thus the minutes show the persons to whom stock was issued, the date of the issuance, the description and the amount of the consideration, the number of shares issued pursuant to the plan, and the capital limitation.

Since the minutes show the issuance of fifty (50) shares of stock pursuant to the plan which appear to be all the stock to be issued, there was no other equity interests the taxpayer may have in the corporation to be distinguished by the records.

POINT II

THE TAX COURT ERRED IN ITS FINDINGS THAT A PRESUMPTION ARISES THAT INFORMATION THAT THE PETITIONER DID NOT INTRODUCE AT THE TRIAL WOULD NOT SUPPORT PETITIONER'S CLAIMS WITH REFERENCE TO THE ISSUANCE OF SEC. 1244 STOCK.

The Tax Court in its decision on page 14 stated: (A.26)

"Petitioner concededly had the Realty Transfer stock book in his possession yet he did not introduce them into evidence at trial. Thus a presumption arises that the information contained therein would not support the petitioner's claim to the deduction."

2

In addition, a person who owns section 1244 stock in a corporation shall maintain records sufficient to distinguish such stock from any other stock he may own in the corporation. (Reg. Sec. 1.1244(e)-1).

Although this is the general rule it does not apply with reference to the circumstances of the issuance of Sec. 1244 stock. It has been held repeatedly that the issuance of a certificate is not necessary to constitute one a stockholder, and it has been specifically applied to Sec. 1244 stock. This was clearly spelled out by the Court in Wesley H. Morgan 46 TC 879 (1966).

"Since 1244 does not define the word "issued" as used therein; we therefore must assume that it was used in its ordinary corporate sense. Hanover Bank v. Commissioner, 369 U.S. 672, 687; In Re: Nissen's Estate, 345 F.2d 230. Generally, the issuance of a certificate is not necessary to constitute one a stockholder. Also, the date of delivery of the certificate is not controlling as to the date a subscriber becomes a stockholder. The stock certificate is merely the documentary evidence of membership in a corporate organization and an attestation of the stockholder's ownership of shares of interest therein. 11 Fletcher, Cyclopedia of the Law of Private Corporations, secs. 5092-5094 (1958 rev.); Fletcher, supra secs. 1375-1376, 1406, 1427-1428 (1965 rev.) Likewise, when stock is paid for, it is normally considered issued in fact irrespective of the manual issuance of the certificate. W.F. March, 12 T.C. 1083; 11 Fletcher, supra sec. 5159; 3B Mertens, Law of Federal Income Taxation, sec. 22,104, pp.446-447. In Thomas V. Thomas 70 Colo. 29,197 Pac. 243 the Court held that stock certificates are merely secondary evidence of ownership, useful for purposes of transfer; and represent the official declaration by the corporation of what may already appear upon its books. We do not believe that the date of physical issuance of the stock certificate is controlling as to the date of issuance of the stock in ordinary corporate usage and we do not think it was intended to be controlling as to when stock is considered issued for purposes of Sec. 1244."

It is clear that the physical issuance of the stock certificate does not determine the issuance of stock pursuant to Sec. 1244 but when the stock is paid for. Roland E. Scott 27 CCH Tax Ct. Mem. 735 (1968), Herbert S. Lichtenberg 26 CCH Tax Ct. Mem. 583 (1967).

The physical evidence of the stock certificate, if introduced by the petitioner at the trial, could not control the determination of the issuance of Sec. 1244 stock pursuant to a plan and thus could not support the petitioner's claim to the deduction.

Clearly, since the physical evidence in the petitioner's possession could not control the determination of the issuance of Sec. 1244 stock, the presumption that the information would not support the petitioner's claim must fall.

The Tax Court in its decision on page 9 stated:(A.27)

"What is crucial, petitioner claims, is the payment of consideration therefor, and petitioner has established his investment in Realty Transfer, a fact which respondent does not challenge".

Since the respondent does not challenge the petitioner's investment in Realty Transfer, and the Sec. 1244 stock is deemed issued when paid for, then the corporate minutes dated June 4, 1962, the records maintained by the accountant, Frank Knopf clearly establish the issuance of the stock to petitioner.

CONCLUSION

The petitioner has met his burden with respect to the adoption of a plan to issue Sec. 1244 stock and with respect to the issuance and payment for Sec. 1244 stock.

The petitioner has presented evidence of a plan which meets all the requirements of Sec. 1244. The corporate minutes dated June 4, 1962, contain all the elements of a "plan" as specified in that section of the Code and the regulations. The minutes together, with the corporate tax returns and the accounting records maintained by the accountant, Frank Knopf, clearly represent sufficient evidence to meet his burden under Sec. 1244. The petitioner is entitled to an ordinary loss of \$27,782.96 and a capital loss for the balance of \$56,804.10.

The decision of the Tax Court should be reversed.

Respectfully submitted,

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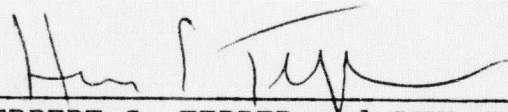
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The undersigned, being one of the attorneys for IRVING MALAWER and RUTH MALAWER, Appellants, herein certifies that on June 9, 1976 he served the three (3) copies of the Brief and Appendix by mailing copies thereof by ordinary mail postage prepaid addressed to Scott P. Crampton, Assistant Attorney General, Tax Division, U.S. Department of Justice, Washington, D.C. 20530, attorney for Appellee.



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